HOUSE OF LORDS SESSION 2006–07
[2007] UKHL 35

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OPINIONS

OF THE LORDS OF APPEAL FOR JUDGMENT IN THE CAUSE

Jones (Respondent)
v.
Garnett (Her Majesty's Inspector of Taxes) (Appellant)

Appellate Committee

Lord Hoffmann
Lord Hope of Craighead
Lord Walker of Gestingthorpe
Baroness Hale of Richmond
Lord Neuberger of Abbotsbury

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LORD HOFFMANN

My Lords,

1. Chapter IA of Part XV of the Income and Corporation Taxes Act 1988 contains anti-avoidance provisions intended in principle to prevent people from reducing their tax liabilities by settlements, gifts or similar arrangements which transfer income or income-producing assets to their minor children or under which they or their spouses retained an interest. These provisions go back many years.

2. The question in this appeal is whether they apply to the arrangements made by Mr and Mrs Jones to distribute the income of a company through which Mr Jones, with back-office support from Mrs Jones, traded as a computer consultant. When Mr Jones was made redundant in 1992, he decided to go freelance. He and his wife acquired a shelf company called Arctic Systems Ltd; the formation agents sold them the two issued £1 shares for £1 each and Mr Jones was appointed sole director. Mrs Jones was appointed secretary. It appears that the agencies through which computer consultants offered their services insisted upon dealing only with companies, presumably to avoid any possible argument that the consultant was in substance an employee.

3. The company then entered into contracts with customers to provide the services of Mr Jones. The performance of these services generated the company's income. Mrs Jones did the book keeping, dealt with the bank and the insurance company, paid tax and VAT and attended to correspondence. This took four or five hours a week.

4. The income was distributed on the advice of their accountant. The agreed statement of facts says that in the relevant year 1999-2000, the company's receipts were £78,355. Mr Jones took £6,520 as salary and Mrs Jones £3,600. The latter is accepted to have been a reasonable figure for Mrs Jones's services but the former figure is, given the company's receipts, plainly less than Mr Jones could have earned in the market. After these and other deductions, the company's taxable profits were £26,372, on which it paid £4,927 corporation tax. It is said to have declared and paid dividends of £25,767.25 to each of the shareholders, but given the amount of distributable profits, this may be a mistake. The precise figures do not however matter. The pattern of distribution over the previous years had been much the same.

5. The tax advantages to Mr and Mrs Jones of receiving the company's earnings as dividends rather than salary were, first, that National Insurance Contribution would have been payable on salary but was not payable on dividends and, secondly, that the dividend payable to Mrs Jones was taxable at a lower rate than it would have been if added to the income of Mr Jones. For these reasons, it was contemplated from the outset that the company would pay Mr and Mrs Jones low salaries and distribute the rest of its income as dividends.

6. The following are the provisions of Chapter IA which are said to apply to these arrangements:

> 660A.—(1) Income arising under a settlement during the life of the settlor shall be treated for all purposes of the Income Tax Acts as the income of the settlor and not as the income of any other person unless the income arises from property in which the settlor has no interest.
>
> (2) Subject to the following provisions of this section, a settlor shall be regarded as having an interest in property if that property or any derived property is, or will or may become, payable to or applicable for the benefit of the settlor or his spouse in any circumstances whatsoever.
>
> …
>
> (6) The reference in subsection (1) above to a settlement does not include an outright gift by one spouse to the other of property from which income arises, unless—
>
> (a) the gift does not carry a right to the whole of that income, or

(b) the property given is wholly or substantially a right to income.

For this purpose a gift is not an outright gift if it is subject to conditions, or if the property given or any derived property is or will or may become, in any circumstances whatsoever, payable to or applicable for the benefit of the donor.

660G.—(1) In this Chapter—

'settlement' Includes any disposition, trust, covenant, agreement, arrangement or transfer of assets, and

'settlor', in relation to a settlement, means any person by whom the settlement was made.

(2) A person shall be deemed for the purposes of this Chapter to have made a settlement if he has made or entered into the settlement directly or indirectly, and, in particular, but without prejudice to the generality of the preceding words, if he has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement.

7. Not every transfer of property is a settlement for the purposes of section 660A. There has to be an "element of bounty" in the transaction. This old-fashioned phrase, apparently derived from the judgment of Plowman J in *Commissioners of Inland Revenue v Leiner* (1964) 41 TC 589, 596 and approved by the House of Lords in *Inland Revenue Commissioners v Plummer* [1980] AC 896, 913, conjuring up the image of Lady Bountiful in *The Beaux' Stratagem*, is perhaps not the happiest way of describing a provision for a spouse or minor children. A donation to a spouse or child is traditionally expressed in a deed to be "in consideration of natural love and affection" rather than the donor's bounty. It is nevertheless exactly the kind of thing at which the anti-avoidance provisions are aimed. In *Chinn v Hochstrasser* [1981] AC 533, 555 Lord Roskill cautioned against treating the word "bounty" as if it had been included in the statute. It seems to me that the general effect of the cases is that, under the arrangement, the settlor must provide a benefit which would not have been provided in a transaction at arms' length.

8. The Revenue's case is straightforward. They say that the acquisition of the company and the transfer of a share to Mrs Jones, enabling her to receive the dividends which were expected to be paid,

was an arrangement. It was not a transaction at arms' length because Mr Jones would never have agreed to the transfer of half the issued share capital, carrying with it an expectation of substantial dividends, to a stranger who merely undertook to provide the paid services which Mrs Jones provided. That provided the necessary "element of bounty". The object of the arrangement was to keep the entire income within the family but to gain the benefit of using up Mrs Jones's lower rates. The dividends paid to Mrs Jones arose under the arrangement. Mr Jones, by working for the company, provided it with the funds which enabled the dividends to be paid. He was therefore a settlor within the meaning of section 660G(2). As Mrs Jones was the spouse of Mr Jones, he was to be treated as having an interest in the income derived from her share and that income was therefore to be treated as his income. I shall postpone consideration of why the Revenue say that the exception in section 660A(6) does not apply.

9. Park J accepted this argument but the Court of Appeal [2006] 1 WLR 1123 did not. Sir Andrew Morritt C said, at para 73, that Mrs Jones had acquired her share "for value", i.e. for £1 "in the context of a joint business venture to which both parties made substantial and valuable contributions". What happened thereafter, namely that Mrs Jones was paid a salary and in addition was paid dividends derived entirely from her husband's work, was not part of the arrangement because these events depended upon the future business of the company and decisions on dividend policy by Mr Jones, all of which were uncertain. They could not therefore supply the necessary element of bounty.

10. I must respectfully disagree. In my opinion the analysis is divorced from reality. Mrs Jones could not have been issued with a share without the agreement of her husband and when he agreed to that arrangement, it was expected that he would take a low salary and that substantial dividends would be distributed. That was the advice which they had received from the accountant. And that was what happened. Each year the salaries were set at a level suggested by the accountant and the rest retained or distributed as dividend. The decisions were tax driven and not commercially driven. And it was necessary, in order to gain the tax benefit, that Mr Jones should, in a broad sense, transfer some of his earnings to his wife.

11. Authority for taking a broad and realistic view of the matter may be found in several cases of which the most relevant is *Crossland v Hawkins* [1961] Ch 537. This concerned section 397 of the Income Tax

Act 1952, the effect of which is now reproduced in section 660B of the 1988 Act. It is, for all relevant purposes, in terms similar to section 660A, except that instead of applying when an interest under the settlement is retained by the settlor or his spouse, it applies when income arising under the settlement is paid for the benefit of a minor child of the settlor.

12. On 3 December 1954 the actor Jack Hawkins caused a company named Roehampton Productions Ltd to be formed with an authorised share capital of £100, of which two shares were subsequently issued to two clerks employed by his solicitors. On 10 December 1954 he agreed with the company to make his services available as the company should direct for a salary of £50 a week. On 3 March 1955 Mr Hawkins' father-in-law settled £100 on trust for Mr Hawkins' three minor children and the trustees used this money to subscribe for the 98 unissued shares in the company. In 1956 the company was paid £25,000 for Mr Hawkins' services in a film and on 18 October 1956 it paid a dividend of £500 to the trustees, most of which they distributed to the minor children. The question was whether, under the predecessor of section 660B, this income should be treated for tax purposes as the income of Mr Hawkins.

13. The taxpayer argued that there was no arrangement to which the section could apply. At the time when Mr Hawkins agreed to supply his services to the company, the settlement by which his children acquired an interest in the company was not in contemplation. Donovan LJ said, at pp 549-550:

> "I do not think that the language of section 397 requires that the whole of the eventual arrangement must be in contemplation from the very outset…I think there is sufficient unity about the whole matter to justify it being called an arrangement for this purpose, because, as I have said, the ultimate object is to secure for somebody money free from what would otherwise be the burden or the full burden of surtax. Merely because the final step to secure this objective is left unresolved at the outset, and decided on later, does not seem to me to rob the scheme of the necessary unity to justify it being called an 'arrangement'."

14. Holroyd Pearce LJ pointed out, at p 553, that the whole scheme followed proposals put forward by Mr Hawkins' solicitors and accountants and that —

> "The foundation for those proposals was his earning power and they needed not merely his assent but his active participation."

15. *Butler v Wildin* (1988) 61 TC 666 also concerned the provision for settlements for the benefit of minor children, by then contained in section 437 of the Income and Corporation Taxes Act 1970. In September 1980 two brothers, Graham and Garry Wildin, who each had two minor children, started negotiations with British Rail to acquire a long lease of some land which they thought presented a profitable investment opportunity. They acquired a shelf company with an authorised share capital of £100 and allotted 19 shares to each of the four children. Each child paid for the shares out of money in a savings account. They then arranged for the company to acquire the lease and undertake the development. By 1982 the development was complete. In 1985 the company made a profit and paid the children a dividend. The question was whether it should be treated as income of the brothers.

16. Vinelott J decided, at pp 683-684, that the brothers were parties to an arrangement and that the dividends were paid to the children in consequence of that arrangement:

> "The brothers together arranged for shares in the company to be allotted to the four…children; and they arranged for negotiations with British Rail to be opened, for the agreement with British Rail to be entered into and for the site to be developed by the company. The steps they took were throughout directed to achieving the end that was in fact achieved, namely of ensuring that the company and so indirectly the four…children (to the extent of their respective shareholdings) took the benefit of the development of the site at no cost or risk to themselves."

17. As in this case, the taxpayers argued that there was no "element of bounty" because the children had paid for their shares out of their own money. Vinelott J said, at p 684:

> "The children contributed nothing except the trifling sums which I must assume were paid on the allotment of the shares. They were exposed to no risk …. The risk that the development would not prove profitable and might result in loss was taken by the brothers."

18. As in this case, there was no assurance that dividends would ever be paid. That depended upon whether the company made a profit: as Vinelott J said, at p 685:

> "The future of the company depended on the maintenance of a sufficient surplus over the rent payable to British Rail to meet the interest on the bank borrowing; a modest decline in the profit rental or a modest increase in the rate of interest might have had a catastrophic effect on the ability of the company to continue to service its debt…"

19. Similarly, even if the company made a profit, the payment of a dividend depended upon the decision of the brothers who were at all material times the sole directors.

20. Sir Andrew Morritt C distinguished *Crossland v Hawkins* [1961] Ch 537 on the ground that the arrangement included a binding contract by Mr Hawkins to serve the company for £50 a week. In this case, there was no such contract. Mr and Mrs Jones agreed their salaries retrospectively from year to year on the advice of the accountant. But I do not think that this makes a difference. The Wildin brothers were not obliged to fund the development by the company. They could have stopped at any time. I agree with Park J, who said in this case (at [2005] STC 1667, 1709, para 39) that it would have made no difference if there had merely been expectations that Jack Hawkins would work for the company at a salary to be fixed from time to time and that in practice the salary would be set at a low level. As the value of a share always depends upon expectations of future yield, such expectations would give the shares a far greater value than the nominal sum for which they were transferred.

21. As for *Butler v Wildin* (1988) 61 TC 666, Sir Andrew Morritt C summarises the facts and remarks without further comment, at para 78, that Vinelott J appears to have considered that the acquisition of the shares, the agreement with British Rail and the development of the land

were all part of one arrangement. I do not think that is right, because Vinelott J says (at p. 678) that—

> "the relevant date for determining whether there was an arrangement by virtue of which income was paid to the brothers and to the children is the date when the company was acquired and its shares were allotted."

22. That is not to say that a series of steps which are contemplated in advance cannot together constitute an arrangement. That appears to have been the case in *Crossland v Hawkins* [1961] Ch 537. But I would have found it difficult to say that in *Butler v Wildin* the subsequent agreement with British Rail and the development were part of the arrangement. They depended, as Sir Andrew Morritt said of this case, upon extraneous events and decisions which had not been made. It was the *expectation* of such events and the hope of profit which, together with the absence of any risk attached to the children's ownership of the shares, gives the "element of bounty" to the arrangement constituted by the allotment. What subsequently actually happened was not part of the arrangement but the way in which (as foreseen) income arose under the arrangement. I think that this analysis (which Keene LJ said he had initially found persuasive) is correct.

23. Carnwath LJ made a rather different point when he said, at para 108, that this was the first time in which the revenue had sought to apply the concept of a "settlement" in sections 660A or 660B to —

> "a normal commercial transaction between two adults, to which each is making a substantial commercial contribution, albeit not of the same economic value."

24. I cannot agree that this was a "normal commercial transaction between two adults." It made sense only on the basis that the two adults were married to each other. If Mrs Jones had been a stranger offering her services as a book keeper, it would have been a most abnormal transaction. It would not have been an arrangement into which Mr Jones would ever have entered with someone with whom he was dealing at arms' length. It was only "natural love and affection" which provided the consideration for the benefit he intended to confer upon his wife. That is sufficient to provide the necessary "element of bounty".

25. That brings me to the question of whether the respondents fall within the exception created by section 660A(6). The background to that provision is that until 1989 the income of a wife was deemed for tax purposes to be that of the husband. The then equivalent of section 660(A) therefore had no practical application to a settlement under which income accrued to a wife because that income was deemed in any case to be that of the husband.

26. The question in this case only became of practical importance when separate taxation of husband and wife was introduced by the Finance Act 1989. That did not mean, however, that Parliament was necessarily willing to allow one spouse to reduce his or her liability to taxation by arrangements by which the one transferred the right to part of his income to the other, any more than to their minor children. But section 660(A)(6) (the provisions of which were originally inserted into the 1988 Act by section 108 of the Finance Act 1989) creates an exception for cases in which one spouse makes an "outright gift" to the other of the property from which the income arises. Thus a gratuitous transfer of quoted shares from husband to wife, although obviously a settlement for the purposes of section 660A, is excluded from the section and the income is taxed as the wife's income.

27. Does this apply equally to the transfer to Mrs Jones of her share in Arctic Systems Ltd, from which her dividend income arose? The Revenue say no for three reasons. First, they say there was no gift of the share by Mr Jones to Mrs Jones. He never owned the share which she took. It belonged to the formation agents and Mrs Jones bought it from them for £1.

28. In my opinion this narrow analysis of the transaction would be inconsistent with the reasoning by which I think that the transfer comes within section 660A in the first place. It was Mr Jones's consent to the transfer of a share with expectations of dividend to Mrs Jones for £1 which gave the transfer the "element of bounty" for the purposes of section 660A. By the same token, I think it made the transfer a "gift" for the purposes of subsection (6). And there is no dispute that, if it was a gift, it was outright.

29. The second argument is that the transfer of the share was not the whole of the arrangement, which included the provision of services by Mr Jones, the dividend policy and so forth. Again, I think that would be inconsistent with the argument by which the revenue have, in my

opinion, succeeded on the first point. The transfer of the share was in my opinion the essence of the arrangement. The expectation of other future events gave that transfer the necessary element of bounty but the events themselves did not form part of the arrangement.

30. Finally, the revenue say that the property given, i.e. the share, was "wholly or substantially a right to income". It is true that the value in the share arose from the expectation that it would generate income. But that is true of many shares, even in quoted companies. The share was not wholly or even substantially a *right* to income. It was an ordinary share conferring a right to vote, to participate in the distribution of assets on a winding up, to block a special resolution, to complain under section 459 of the Companies Act 1985. These are all rights over and above the right to income. The ordinary share is different from the preference shares in *Young v Pearce* (1996) 70 TC 331, which conferred nothing except the right to 30% of the net profits before distribution of any other dividend and repayment on winding up of the nominal amount subscribed for their shares. Those shares were substantially a right to share in the income of the company.

31. In my opinion, this arrangement falls within the exception in section 660A(6). I would therefore dismiss the appeal.

LORD HOPE OF CRAIGHEAD

My Lords,

32. I have had the advantage of reading in draft the speeches of my noble and learned friends Lord Hoffmann and Lord Neuberger of Abbotsbury. I agree with them, and for the reasons they give I too would dismiss the appeal. I also agree with the further observations of my noble and learned friend Lord Walker of Gestingthorpe.

33. In common with my noble and learned friends, I think that the argument for the Revenue breaks down on the question whether the ordinary share of £1 which was acquired by Mrs Jones was within the exception in section 660A(6)(b) of the Income and Corporation Taxes Act 1988 because it was "wholly or substantially a right to income". This is the final point dealt with by Lord Hoffmann (para 30). It is the

second argument for the Revenue in Lord Neuberger's analysis (para 92).

34. The answer to that question does not depend on the particular facts of this case. It applies generally to all transactions containing the necessary element of "bounty" where the property given consists of ordinary shares in a company. For the reasons my noble and learned friends have given, an arrangement by which one spouse uses a private company as a tax-efficient vehicle for distributing to the other income which its business generates is likely to constitute a "settlement" on the other spouse within the meaning of section 660G(1) of the 1988 Act. But so long as the shares from which that income arises are ordinary shares, and not shares carrying contractual rights which are restricted wholly or substantially to a right to income, the settlement will fall within the exception created by section 660A(6). This is an important point of general public interest on which I should like to add these brief comments.

35. The rights which attach to shares in a company depend on the contractual relations between the holders of those shares as defined by the articles of association of the company. It is the articles of association that determine questions between ordinary and preference shareholders as to the right to income in the form of dividends, and the right to the repayment of capital and to participate in the distribution of surplus assets in the event of a winding up of the company. They also determine questions as to the right to attend and to vote at general meetings of the company. The general rule is that the profits of a company belong to the ordinary shareholders, subject to the payment of any preference dividend. Then there is the question how surplus assets not required for the discharge of the company's liabilities or the return of paid up capital to the shareholders are to be distributed in the event of a winding up. The rights of the preference shareholders in any particular case will depend on what the articles of association provide. This is because the rights of the shareholders are determined by the terms of the bargain which they made with the company and with each other. The articles must be taken as a complete statement of the rights of the preference shareholders in the winding up: *Scottish Insurance Corporation Ltd v Wilsons and Clyde Coal Co Ltd* [1949] AC 462, per Viscount Maugham at p 481, Lord Simonds at p 488.

36. In *Young v Pearce* (1996) 70 TC 331 the share capital was divided into two classes: 50 preference shares of £1 each, of which 25 were allotted at par to the wives of each of the two taxpayers, and 50

ordinary shares of £1 each which divided equally between the taxpayers themselves. The preference shareholders were entitled to 30% of the net profits for any year in which the profits of the company were to be distributed, the balance of the distributed profits to be paid to the ordinary shareholders. The articles provided that in the event of liquidation the preference shareholders were to be entitled to repayment of the sums subscribed for their shares, but no more. They were entitled to attend and to speak but not to vote at general meetings of the company.

37. In the light of those facts Sir John Vinelott said, at p 346, that the property given in the form of the preference shares was wholly or substantially a right to income. This was because the preference shares entitled the holders to a preferential dividend if the directors decided that the whole or part of the profits arising in any given year were to be distributed and because, apart from that right to income, the only rights were to repayment of the nominal sum paid on the allotment of the shares and the right to attend but not to vote at general meetings of the company. It would not have been accurate to say that the rights attached to the preference shares were wholly a right to income, because of the right to repayment of capital. But there is no doubt that, on the facts of that case, the rights were "substantially" a right to income. That is because there was no right under the articles, after repayment of capital, to participate in any other assets of the company.

38. The position would have been different if the shares in question in *Young v Pearce* had been ordinary shares. The rights which an ordinary shareholder enjoys are not confined wholly, or even substantially, to a right to income. The residue of the assets of the company belongs to the ordinary shareholders, after the rights of creditors and of any preference shareholders have been satisfied. So property given which consists of ordinary shares in a company will always attract the exception in section 660A(6).

39. It is true that Arctic Systems Ltd had no assets when the formation agents sold the two ordinary shares of £1 each at par to Mr and Mrs Jones. But the question whether the property given to Mrs Jones was wholly or substantially a right to income cannot depend on the state of affairs of the company at time of the gift. Parliament cannot have intended that the exception in section 660A(6) would apply only if – to take shares as an example – the settlement was made when the company had built up sufficient surplus assets to be distributed among the ordinary shareholders as capital. The critical words are "a

right to income". It is the rights attached to the asset comprised in the settlement, not the product of their exercise from time to time, now or in the future, that determine whether the exception applies to it.

LORD WALKER OF GESTINGTHORPE

My Lords,

40. I have had the advantage of reading in draft the opinions of my noble and learned friends Lord Hoffmann and Lord Neuberger of Abbotsbury. I agree with them, and for the reasons which they give I consider that the taxpayer succeeds on the section 660A(6) issue, but not on the wider issue of "arrangement". Because these points are of general interest I add some observations of my own. I cannot usefully add to what my noble and learned friends say about "bounty" but I wish to address some other problems arising on the statutory definition of "settlement" as including an "arrangement".

41. In *IRC v Plummer* [1980] AC 896, 911-912, Lord Wilberforce referred to the statutory origins of Part XVI of the Income and Corporation Taxes Act 1970:

> "[Part XVI] includes a number of provisions which have been enacted at different times, the general effect of which is to cause income of which a person has disposed in various ways to be treated, in spite of the disposition, as the income of the disposer. These had been successively enacted in the Finance Acts 1922, 1936, 1938, 1946, inter alia, with increasing severity."

The same is true of sections 660A and 660B of the Income and Corporation Taxes Act 1988 as amended by the Finance Act 1995.

42. The very first of these enactments, section 20 of the Finance Act 1922, was aimed at revocable and short-term dispositions of income, and primarily (though not exclusively) at gratuitous covenants to make annual payments. Before 1922 sums payable under such covenants were treated as charges on (and so deductible from) the payer's taxable

income, even though the covenant did not effect any disposition of property, and created no more than a personal obligation. Section 20(5) provided,

> "the expression 'disposition' includes any trust, covenant, agreement or arrangement."

A comparable definition of "settlement" ("includes any disposition, trust, covenant, agreement, arrangement or transfer of assets") appeared for the first time in subsection (9)(b) of section 21 of the Finance Act 1936 (provisions as to income settled on children), which was capable of applying to covenanted payments as well as to the income of settled property. Covenants continued to have some efficacy for tax purposes (though subject to increasingly stringent conditions) until a general abolition of the relief (for surtax purposes) by section 12 of the Finance Act 1965. The general rule now (for all income tax purposes, though subject to some limited exceptions) is that in order to escape a tax charge the income disposed of must be income from property of which the disponer has entirely divested himself.

43. So the very wide definition of "settlement" in section 660G(1) of the Income and Corporation Taxes Act 1988 (as amended) has a long and fairly complicated pedigree. It is in striking contrast to the definition of "settlement" which applied (through its 80-year life) under the statutory code charging estate duty. Section 22(1)(i) of the Finance Act 1894 defined the term referentially, initially by reference to section 2 of the Settled Land Act 1882: a "classic" settlement, in the convenient expression used in *Chinn v Hochstrasser* [1981] AC 533. A definition of that sort was appropriate for the purposes of estate duty, which was a mutation tax charged on the capital value of property.

44. The progressive elimination of covenanted payments as a means of tax avoidance has in this respect (only) brought the income tax definition of "settlement" a little closer, in its practical application, to the classic meaning. But trying to apply the statutory definition to an arrangement which includes (but is not limited to) a classic settlement can produce a sort of blurred double vision. In *Chamberlain v IRC* (1943) 25 TC 3 , for instance, the court (in applying section 38(2) of the Finance Act 1938) had to identify "the property comprised in the settlement" and to decide whether that settlement ("or any provision thereof") was revocable, and unsurprisingly encountered difficulties in doing so: see in this House the speeches of Lord Thankerton (with

whom Viscount Simon LC and Lord Atkin agreed) at 329, Lord Macmillan at 331 and Lord Romer at 333. That case may be contrasted with *IRC v Payne* (1940) 23 TC 610, a decision on section 38(1) of the Finance Act 1938, where there was no classic settlement of property, only an income covenant in favour of a controlled private company.

45. The most striking example of what I have referred to as double vision is *Chinn v Hochstrasser* [1981] AC 533, in which this House had to consider section 42 of the Finance Act 1965. That section, long since repealed, was the earliest anti-avoidance provision aimed at offshore trusts as a means of avoiding capital gains tax. By the section Parliament lifted the wide income tax definition of "settlement" and applied it to one category of classic settlements (those with settlors based in the United Kingdom, but trustees resident outside the United Kingdom), possibly with insufficient consideration of how this hybrid provision would work.

46. In this case there is no classic settlement, but the exception for an "outright gift" in section 660A(6) raises a similar problem as to identifying the constituents or components of the arrangement to which (as I would hold) Mr Jones was a party.

47. The inclusion in the statutory definition of the very wide word "arrangement" shows that Parliament recognised, as long ago as 1922, that a wealthy taxpayer might be advised to dispose of what would otherwise be his taxable income by relatively complicated or artificial means. These might include a classic settlement, especially when the intended beneficiaries were minor children, but even in that case a classic settlement was not essential (*Copeman v Coleman* [1939] 2 KB 484 is an early example). Other components of the arrangement might be the formation or acquisition of a private company with an unusual share structure, the declaration of abnormal dividends and the granting and exercise of options (as in *Vandervell v IRC* [1967] 2 AC 291) or entering service agreements on unusual terms (as in *Crossland v Hawkins* [1961] Ch 537).

48. An intention to avoid tax is not, I think, absolutely essential. It is possible to imagine that an arrangement planned for some other purpose (such as pre-empting the consequences of insolvency or divorce) could unexpectedly prove efficacious for tax avoidance and amount to an arrangement (and so to a settlement). But usually an intention to avoid or minimise tax can readily be inferred (in this case it was candidly

admitted) and that intention is part of the factual material that has to be looked at in the round. Sir Wilfred Greene MR put it trenchantly in *IRC v Payne* at 626:

> “It appears to me that the whole of what was done must be looked at; and when that is done, the true view, in my judgment, is that Mr Walter Payne deliberately placed himself into a certain relationship to the company as part of one definite scheme, the essential heads of which could have been put down in numbered paragraphs on half a sheet of notepaper. Those were the things which it was essential that Mr Payne should do if he wished to bring about the result desired. He did it by a combination of obtaining the control of the company, entering into the covenant, and then dealing with the company in such a way as to achieve his object. Now, if a deliberate scheme, perfectly clear-cut, of that description is not an ‘arrangement’ within the meaning of the definition clause, I have difficulty myself in seeing what useful purpose was achieved by the Legislature in putting that word into the definition at all.”

49. Some arrangements are planned in minute detail and carried out “with timetables, in almost military precision” (Lord Wilberforce in *IRC v Plummer* at 907). Highly artificial arrangements of that sort led to *W T Ramsay Ltd v IRC* [1982] AC 300 and the other well-known cases which came in its train (which your Lordships need not consider further on this occasion). But a high degree of complexity, artificiality and pre-planning is not essential in order to produce an arrangement. That is well illustrated by *Crossland v Hawkins* [1961] Ch 537 and *Butler v Wildin* (1988) 61 TC 666, both of which are covered at some length in Lord Hoffmann’s opinion. Like Lord Hoffmann, I would adopt the passage in Donovan LJ’s judgment in *Crossland v Hawkins* at 549, where he refers to “sufficient unity.” The taxpayer’s intention to minimise his tax liability by a “definite scheme, the essential heads which could have been put down in numbered paragraphs on half a sheet of notepaper” explains the rationale of the sequence of events, and gives it unity.

50. The Court has been reluctant to try to lay down any precise test for identifying the components of an arrangement or for assessing the “sufficient unity” to which Donovan LJ referred. Sometimes it has been content to conclude that wherever the boundary line is to be drawn, the

taxpayer and his advisers have got themselves into forbidden territory (see for instance the Master of the Rolls in *Payne* at 626, already quoted; Lord Wilberforce in *Chinn v Hochstrasser* [1981] AC 533, 549, and Lord Diplock, dissenting, in *IRC v Plummer* [1980] AC 896, 924). In my opinion the Court's caution has been well-advised. "Arrangement" is a wide, imprecise word. It can ("like settlement" or "partnership", or indeed "marriage") refer either to actions which establish some sort of legal structure (in this case, a corporate structure through which the taxpayer's income could be channelled) or those actions together with the whole sequence of what occurs through, or under, that legal structure, in accordance with a plan which existed when the structure was established. The planned result may be far from certain of attainment. It may be subject to all sorts of commercial contingencies over which the taxpayer has little or no control. But if the plan is successful and income flows through the structure which he has set up, it is "income arising under the settlement."

51. That seems to be the approach taken in most of the authorities. In *Crossland v Hawkins* Donovan LJ said (at 550),

> "Bearing in mind the ultimate object of securing money free from the burden—or the full burden—of surtax, can it matter for present purposes that the precise way of securing this result was not decided upon at the very outset? I think not. An alternative way of looking at the matter would be this: Here the repayment claim is made in the year 1956-57. In that year the arrangement is complete, and that is enough. It would be irrelevant that it came into being by instalments in the year 1954-55. The Revenue looks at the facts of the year being taxed or for which repayment of tax is being sought, and asks in this year 'Is it true to say that there is a settlement of the kind mentioned in the section, and in this year is it true to say that the settlor has provided funds for the purpose of the settlement?'"

In referring to "instalments" Donovan LJ was referring (see at 549) to the formation of Roehampton Productions Ltd, the service agreement of 10 December 1954, the settlement of 3 March 1955 and the transfer or issue (before 31 March 1955) of all the Roehampton shares to the trustees. He does not seem to have regarded Jack Hawkins' performance in 'Fortune is a Woman' or Roehampton's payment of a dividend (which occurred in 1956) as part of the arrangement, but as the arrangement being put to its intended use.

52. That approach is, I think, consistent with what Vinelott J said in *Butler v Wildin* (1988) 61 TC 666, 678. The point that Vinelott J was making was that the Special Commissioner had misunderstood the facts and misdirected himself by focusing on the date of incorporation of an off-the-shelf company whose shares the taxpayers did not acquire until over two months later. It was during that period that the taxpayers came across their business opportunity. That opportunity might have come to nothing (the judge, at 685, clearly thought it a very risky venture.) But when it did prove profitable the dividend income paid out by the company was income paid "by virtue or in consequence of" the statutory settlement constituted by the arrangement. I would add that in my opinion the wording of section 660A(1) ("income arising under a settlement") does not impose a more demanding test, and may impose a rather less demanding test of causal connection, than the expression "by virtue and in consequence of."

53. I have gone into these points in some detail because they do to my mind have a bearing on the "outright gift" issue. It has been said that it is necessary to identify "the arrangement": Vinelott J said that in *Butler v Wildin* (at 684), and the Master of the Rolls said much the same in *IRC v Payne* (at 626) nearly fifty years before. Normally (there may be exceptions) the arrangement is to be identified by the constituent parts or components of the legal structure designed for a purpose, and not by what is done (sometimes months or even years later) in using the structure for its intended purpose.

54. The Revenue argued that the arrangement entered into by Mr and Mrs Jones included, but was larger than (and so different from) the establishment of the original corporate set-up under which each had half of the issued share capital of Arctic Systems Ltd ("Arctic"). I do not accept that argument. There was no written service agreement between Arctic and Mr Jones comparable to the service agreement between Roehampton and Jack Hawkins. The establishment of the corporate set-up, together with the common intention that Mr and Mrs Jones would use it to minimise tax in accordance with their accountants' advice, was the essential arrangement. What happened afterwards was that the arrangement was put to its intended use.

55. Mr Jones did not actually make a transfer by way of gift to his wife of one of the two issued shares in Arctic. She bought it at par from the company formation agents. But it was not the sort of arrangement that would have been made between strangers dealing with each other at arm's length. Arctic was the chosen vehicle through which Mr Jones was to offer his valuable services as an IT consultant, and it was an act of bounty on his part to permit his wife to acquire half its equity for the nominal sum of £1. In my opinion that amounted to an outright gift of the share within the meaning of section 660A(6). I respectfully disagree with Park J's contrary conclusion because I think he took too expansive a view of the scope of the statutory settlement. I prefer the tentative view expressed by Sir John Vinelott in *Young v Pearce* (1996) 70 TC 331, 346.

56. I have found the condition in section 660A(6) (b) "the property given is wholly or substantially a right to income" rather more difficult. The property given was an ordinary share—in fact, half the issued ordinary share capital of Arctic—and so it was certainly not "wholly . . . a right to income." If the plan worked it could be expected to produce a healthy dividend income but not to attain any significant market value (it would hardly be marketable at all on the basis that Arctic was a going concern, since Mr Jones could not be expected to continue to work under an arrangement which channelled nearly half his earnings to a stranger). But at the outset there was at least the possibility that Arctic would build up a reserve of undistributed income, and the agreed statement of facts and issues suggests that this occurred (because of IR35) during 2000-1 and 2001-2. The decision of Sir John Vinelott in *Young v Pearce* (1990) 70 TC 331 is distinguishable because of the very unusual rights conferred on the preference shares (under new articles of association which were part of the arrangement) in that case.

57. For these reasons, and for the further reasons given by Lord Hoffmann and Lord Neuberger, I would dismiss this appeal.

BARONESS HALE OF RICHMOND

My Lords,

58. Income tax was invented only decades after Blackstone (*Commentaries*, Book 1, p 442) had given his classic definition of the relationship between husband and wife at common law:

> "By marriage, the husband and wife are one person in law; that is, the very being or legal existence of the woman is suspended during the marriage, or at least is incorporated and consolidated into that of her husband; under whose wing, protection, and *cover*, she performs everything; and is therefore called in our law-French a *feme-covert* . . . "

At that date, a husband was absolutely entitled to his wife's earnings. He was not entitled to the income from property which had been settled to her separate use. Nevertheless, from its very beginnings the tax system decided to treat all her income, earned and unearned, as her husband's income. He was liable to declare it to the Revenue and he was liable to pay the tax on it. The 1799 Act which first introduced income tax provided that a married woman's income was to be stated and accounted for by her husband. In 1806, it was provided that the wife's profits should be deemed to be those of her husband. This remained the basic rule until 1990.

59. No doubt this was a convenient solution, avoiding the sort of difficult questions which this case has raised. It was so convenient that it continued after the Married Women's Property Act 1870, when wives became entitled to keep their earned incomes, and after the Married Women's Property Act 1882, when all a wife's property and income from any source was deemed to be her separate property. In some cases it also raised more tax, for example where the couple's combined incomes made them liable to surtax or to higher rates of tax to which they would not have been liable if separately taxed. In others, the effect might be offset by the higher married man's allowance (introduced in 1918) and the wife's earned income allowance (introduced in 1920).

60. Two Royal Commissions thought that the aggregation rule was not only convenient but principled: the taxable capacity of a married

couple depended upon the total income coming into the household and not upon the chance of how it was owned between them (*Royal Commission on the Income Tax,* 1920, Cmd 615, para 259; *Royal Commission on the Taxation of Profits and Income, Second Report*, 1954, Cmd 9105, para 120). Others thought that it was inconsistent both with the principles of separate property and of equality between husband and wife. It was abandoned in stages.

61. The possibility of separate assessment was introduced in 1914. Either spouse could apply to be separately assessed. This did not affect the principle of aggregation or the total amount of tax payable. This was simply apportioned between them and the wife became solely liable for the part apportioned to her. She could, if she wished, complete her own tax return and thus maintain a degree of privacy from her husband.

62. The next stage, introduced in 1971, was to allow the spouses jointly to elect that the wife's earned income be separately taxed. This reduced their personal allowances to those of two single people but meant that they were less likely to reach the higher rates of tax. The husband remained liable to be taxed on the wife's unearned income. He also remained responsible for completing their tax returns unless either had also applied for separate assessment. The Revenue practice of writing to the husband about his wife's tax affairs (even if she had written to the Revenue) was only changed in 1978 (see *The Taxation of Husband and Wife*, 1980, Cmnd.8093, para25).

63. The final stage, reached when the relevant provisions of the Finance Act 1988 came into force in 1990, was to abolish the aggregation rule altogether and treat them as two separate individuals.

64. The provisions which we have to construe were part of the same package. The green paper on *The Taxation of Husband and Wife* (1980, Cmnd 8093, paras 50 and 88) had remarked (echoing the observations of the 1954 Royal Commission, Cmd 9105, para 119):

> ". . . there would be a potential tax advantage to be gained by transferring income from the better-off husband (or wife) to the other spouse. With earned income the opportunity for splitting income in this way hardly arises, except perhaps where the wife works for her husband. With investment income, however, the opportunities

> would clearly be much greater. In so far as this could lead to a more even distribution of the underlying capital between husbands and wives, this may be regarded as no bad thing. . . . But in any case . . . it would be necessary to give consideration to the prevention of artificial methods of reducing the tax bill by transferring income from husband to wife or vice versa.”

65. Hence the new provisions in section 660A were closely modelled on those designed to stop fathers from taking advantage of the fact that their minor children were treated as separate individuals for income tax purposes by settling income-producing property upon them. The aim was to prevent artificial transfers of income from father to child or husband to wife. But, consistently with the policy of exempting outright transfers of property between spouses from capital transfer tax and inheritance tax, an exception was made for outright gifts. The policies are easy to state. But it is not easy to translate them into statutory language which exactly captures the promoters’ intent. It is some comfort that the professional judges who have so far decided this case have reached such different conclusions and that we have reached different conclusions from them all.

66. I agree, for the reasons given by my noble and learned friends Lord Hoffmann, Lord Hope of Craighead, Lord Walker of Gestingthorpe and Lord Neuberger of Abbotsbury, that if this was a “settlement” for the purpose of section 660A(1) of the Income and Corporation Taxes Act 1988, it fell within the exception for “an outright gift” in section 660A(6). There is no need for me to say anything more about that. But I confess to having had rather more difficulty than they in concluding that this was a “settlement” at all.

67. When a husband and wife team set up a family business through the machinery of a private company in which they each have an equal number of shares, they may have clear expectations of what the future will hold or they may not. If combined with low salaries and high dividends, as things stand at present, the arrangement will always result in lower national insurance contributions and lower income taxation. But as I understand it, the Revenue is anxious to catch only one of the following examples: (i) they may expect that each will make a contribution to the company’s earnings of roughly equal financial value; (ii) they may expect that each will make a contribution which is equal in terms of effort but (not least because of historic discrimination between the price of different kinds of services in the market place) unequal in

terms of earnings for the company; (iii) they may expect that each will contribute what they can but that those contributions will vary over time, perhaps because of personal factors such as illness or child rearing, perhaps because of changes in the business and its market; or (iv), as here, they may expect that one will contribute the work which brings in the money from outside while the other will contribute the limited but necessary ancillary services to make that work possible but bring in no independent money from outside. There are many variations and permutations between these possibilities.

68. I would have found it easier to understand the Revenue's case if it had adopted a year by year approach: looking at each tax year, has one of the spouses worked for a salary which is seriously less than his services are worth to the company in order to boost the company's profits which can then be distributed equally between the spouses as dividend? In other words, has there been a gratuitous transfer of income between husband and wife? This would be a practical way of catering for the uncertainties and vicissitudes of family life and family business, while meeting the policy objectives discussed earlier.

69. But the Revenue has expressly eschewed that approach. It relies on the initial acquisition of the company's shares as the "settlement". It has also expressly eschewed the intention of catching any other type of arrangement than that in example (iv) above. It is not interested in picking apart genuinely co-operative family ventures, even if on analysis the contribution of one spouse is worth more than the contribution of another. Nor can it be interested in arrangements which start out as roughly equal ventures but for one reason or another become less equal as time goes by. On the Revenue's case, it is only a "settlement" if a substantial element of "bounty" – that is, gratuitous transfer – is contemplated at the outset. It must follow that unanticipated later events cannot transform the character of the initial transfer of property or arrangement.

70. The problem with that approach, as my lords have shown, is that what makes the arrangement gratuitous (I refuse to use the patronising and inaccurate term "bounteous") also makes it a gift. And an ordinary share carries with it much more than a right to income. So the exception in section 660A(6) applies. As already seen, there is nothing contrary to policy in one spouse making an unconditional and irrevocable transfer to the other of property even if it carries with it the right to substantial unearned income.

71. Thus my reservations about the Revenue's case that this is a settlement at all are very similar to those of the Chancellor: it only becomes a "settlement" within the meaning of section 660A(1) because of expectations about later events which are too uncertain and fluid to be included as part of the initial arrangement. However, in view of our unanimous conclusion that this appeal should be dismissed, it would be presumptuous of me to reach a different conclusion on the settlement point.

LORD NEUBERGER OF ABBOTSBURY

My Lords,

72. I have had the benefit of reading a draft copy of the speeches of my noble and learned friends Lord Hoffmann and Lord Walker of Gestingthorpe, and I am of the view that this appeal should be dismissed for the reasons they have given. The case raises points of some difficulty, it is significant to a number of people, and it has attracted media coverage in the professional press, and, unusually for a revenue case, more widely. Accordingly, I propose to express my views in my own words.

73. This appeal raises two issues in relation to section 660A of the Income and Corporations Taxes Act 1988. The first issue is whether, there was, on the facts of this case, "a settlement" within the meaning of section 660A(1) as expanded by section 660G(1). If the answer is in the affirmative, then the second issue which arises is whether, on the facts of this case, there was "an outright gift" within the meaning of section 660A(6). In order to succeed on their appeal, and establish that the dividends received by Mrs Jones are to be treated as the chargeable income of Mr Jones, the Revenue need to make good their contention on both issues, namely that there was "a settlement", and that it did not amount to "an outright gift".

74. The difficulty arising from the two issues is well illustrated by the difference of judicial opinion in this case. The senior general commissioner found for the Revenue on both issues; the junior commissioner found against the Revenue on both issues. Park J found for the Revenue on both issues but his main reason on the second one was different from that of the senior commissioner. The Court of Appeal

found against the Revenue on the first issue, but would have been for the Revenue on the second issue, although disagreeing with the reason of the senior commissioner. Your Lordships agree with the Revenue on the first issue, but are against them on the second.

The first issue: was there an "arrangement"?

75. The definition of "settlement" in section 660G (1) appears, on its face, to be very wide indeed, and its ambit (or, to be more accurate, the ambit of its statutory predecessors) has been somewhat circumscribed by the courts. It is not surprising that the legislature and the courts have been content for the law to develop in this way. One of the principal purposes of section 660A is (save in certain circumstances - see e.g. section 660A(6)) to defeat arrangements between spouses, not conducted at arm's length, which seek to equalise their income, thereby reducing their aggregate liability to income tax and national insurance charges. The legislature has given effect to this by defining "settlement" in very wide terms, and the courts have then given the definition a limited effect, by means of the technique of purposive interpretation, through the introduction of the concept of "bounty" – see for instance per Lord Wilberforce in *Inland Revenue Commissioners v Plummer* [1980] AC 896 912E-F.

76. The word "bounty" rings slightly uncomfortably, at least to my ears. It seems a somewhat outdated expression which smacks of condescension. However, in the light of the judicial decisions on these provisions, it seems to me that the law is now tolerably clear and sensible, and, particularly given the need for clarity and the room for difficulties in this area, it would be inappropriate to risk introducing uncertainty or new complications by redefining the principles, even if only linguistically.

77. The dispute between the parties on the first issue is whether there was an "arrangement" falling within the ambit of sections 660A (1) and 660G (1) when one of the two subscriber shares in Arctic Systems Ltd ("the company") was transferred to Mrs Jones on 11 August 1992, in the circumstances explained by Lord Hoffmann. For the taxpayer, Mr Gammie QC contended that this did not amount to an "arrangement" because it lacked the necessary element of bounty. He relied on the fact that the company had no assets other than the £2 derived from the two subscriber shares: therefore Mrs Jones got what she paid for. The profits which subsequently accrued to the company through the skill and efforts

of Mr Jones were no more than a hope or at best, an expectation, that could not, he said, be counted as an asset of the company because the company had no legal right to require Mr Jones to work, whether for the company's benefit or at all, let alone for a reduced level of remuneration.

78. In my judgment, although the Court of Appeal was convinced by that argument, it is inconsistent with both authority and principle, and should be rejected.

79. It seems to me clear that, when considering whether there was an "arrangement" within the meaning of the sections, i.e. an arrangement which involved an element of bounty, one should assess the position at the time that the alleged arrangement was made, but, in carrying out that exercise, one should not disregard what happened thereafter. In particular, if the parties intended an element of bounty to accrue, and that element of bounty does indeed eventuate, then, absent any other good reason to the contrary, there is indeed an "arrangement" within the meaning of section 660G (1).

80. In this connection, as long ago as 1940, in *Commissioners of Inland Revenue v Payne* (1940) 23 TC 610, Sir Wilfred Greene MR discussing a somewhat more simply drafted statutory predecessor of the sections in question here, namely section 38 of the Finance Act 1938, said this, at p 626, in relation to a scheme whose details are not of significance for present purposes:

> "The word 'arrangement' is not a word of art. It is used, in my opinion, in this context in what may be described as a business sense, and the question is: can we find here an 'arrangement' as so construed? It is said that the only element in this transaction which falls within the definition of 'settlement' is the deed of covenant itself. I am unable to accept that argument. *It appears to me that the whole of what was done must be looked at*; and when that is done, the true view, in my judgement, is that Mr Walter Payne deliberately placed himself into a certain relationship to the company as part of one definite scheme......He did it by a combination of obtaining the control of the company, entering into the covenant *and then dealing with the company in such a way as to achieve his object*" (emphasis added).

81. *Crossland (Inspector of Taxes) v Hawkins* [1961] 1 Ch. 537 is another decision of the Court of Appeal which appears to me to be in point. It was a case concerned with sections 397 and 403 of the Income Tax Act 1952. Again, the detailed facts do not matter. What seems to me to be important for present purposes is what was said by Donovan LJ at 547:

> "I will accept for the moment the proposition that the family settlement which followed was not decided upon at the outset; but what is important I think, is that the eventual enjoyment by some individual or individuals of the money which had escaped surtax must have been in contemplation at the outset. Otherwise, as I say, the scheme had no rational purpose".

82. I am prepared to accept that in the present case the formation of the company and (more arguably) the allotment of shares had a "perfectly rational purpose", even without the benefit of seeking to equalise the income of Mr and Mrs Jones. However, it seems to me that Donovan LJ's essential point was that, when considering the alleged "arrangement", or to put the same point in another way, in considering whether the arrangement involved an element of bounty, one looks at the whole of the purpose of the arrangement, and, in that connection, one does not shut ones eye to whether that purpose was achieved. That point is reinforced by what Donovan LJ went on to say at 550:

> "Bearing in mind the ultimate object of securing money free from the burden – or the full burden – of surtax, can it matter for present purposes that the precise way of securing this result was not decided upon at the very outset? I think not".

83. On the following page, Donovan LJ specifically disagreed with the view of the judge at first instance that "the deed of settlement came later in date [and the commissioners had found] that there was no comprehensive arrangement at the outset of which the deed of settlement formed part". It is true that, at that point, Donovan LJ was dealing with a question of the identity of the settlor. However, the definitions of settlement in section 660G(1) and of a settlor in section 660G(2) are closely connected, and it appears to me to be perfectly proper to rely upon observations as to what can be taken into account

when considering who is a settlor, when deciding whether there is a settlement.

84. Finally, there is the first instance decision in *Butler v Wildin* (1988) 61 TC 666. Again, it is unnecessary to go into the facts. The important feature for present purposes is that Vinelott J concluded that there was a settlement within the meaning of the immediate statutory predecessor of section 660G(1), namely section 681(4) of the 1988 Act, notwithstanding that, at the time the shares in the company in that case were allotted, it had no right to the benefit of the contract which was ultimately vested in it. The essential point is that the company in question was set up by the taxpayer, and the shares were allotted, in the expectation, indeed with the intention, which duly eventuated, that the benefit of a potentially valuable contract being negotiated by the taxpayer would be taken in the name of, and for the benefit of, that company.

85. Mr Gammie suggested that these cases were distinguishable on the ground that the beneficiaries were the children or grandchildren of the taxpayer, and not as in this case, a spouse. However, although it is fair to say that the statutory provisions relating to the transfer of income-producing assets to a spouse are somewhat different from those relating to children, it seems to me that the applicable principles as to whether a "settlement" has been created must be identical. This is demonstrated by the fact that the provisions of section 660G apply equally to the provisions of section 660B of the 1988 Act ("Payments to unmarried minor children of settlor") as they do to section 660A, which, save in respect of subsection (6) which applies only as between spouses, is general in its application ("Income arising under settlement where settlor retains an interest").

86. In this case, as the facts recited by Lord Hoffmann show, the main reason for allotting one share in the company to Mr Jones and the other share to his wife, and the only reason that Mr Jones was intending to accept, and duly accepted, an artificially low rate of remuneration for his work, was to distribute the income earned by Mr Jones roughly equally between him and his wife. That was the intention of Mr and Mrs Jones (or, perhaps more accurately, the intention of their accountants, which they were happy to adopt) at the time the company was set up, and it was what happened in each financial year (with the exception of two years when, for reasons not germane for the present purposes, owing to a misunderstanding of the law, Mr Jones was paid effectively a full salary). Accordingly, unless we are to overrule the approach adopted

by the Court of Appeal in *Payne* and *Crossland*, and by Vinelott J in *Butler v Wildin*, it seems to me to follow that that there was here an arrangement within the meaning of section 660G(1). In my view, those cases laid down an approach which is workable and fair, which appears to give effect to the legislature's intention, and which, despite opportunities to do so, the legislature has been happy to accept by implication, in that nothing in the various re-enactments since section 38 of the 1938 Act has called the approach into question.

87. It also appears to me that the conclusion is consistent with principle. The fact that the company had no legally enforceable right to require Mr Jones to work for it, either at all or at a reduced level of pay, does not mean that that was not something that the company and its shareholders expected to happen, and which therefore gave the shares value. As Lord Hoffmann pointed out in argument, valuation of an asset, whether land, shares, intellectual property or anything else, is very often based, at least to some extent, on profits which may be hoped or expected to be realised, but to which the owner of the asset has no present legal right. In this case, it can be said that there is a curiosity in that the hope and expectation of profits accruing to the company were (and no doubt still are) limited to the extent that the two shares were owned by Mr and Mrs Jones. In other words, that Mrs Jones's share only had a substantial value at the date it was allotted to her as long as she was its owner and Mr Jones owned the other share. However, the notion that a particular piece of property has value (or has considerably enhanced value) only so long as it is owned by one particular person or class of person, because of some attribute which that person enjoys, or only so long as a particular state of affairs subsists, is conceptually unsurprising and not unfamiliar in practice.

88. The essential point here is that, in the light of reasonable expectations as to what Mr Jones would achieve in terms of winning contracts for the company and would be prepared to accept by way of remuneration (which expectations were in due course fully realised), the value in 1992 to Mrs Jones of her share was considerably greater than the £1 which she paid. In those circumstances, there was indeed an element of bounty involved in her acquisition of the share, and that bounty was provided through the expectation of what Mr Jones would do. The fact that the bounty primarily arose from an expectation of what he would do, rather than from what he had done, does not appear to me to be in point.

89. There is an additional problem if the argument of the taxpayer is correct. If the Revenue's case on the first point is successfully met by the contention that one should limit one's attention to the strictly legally enforceable rights of Mr and Mrs Jones and the company at the time that Mrs Jones acquired her share, then that would open the door to a different approach. That approach would involve considering what transpired each year, when it was decided how much of the company's gross profit should be attributable to Mr and Mrs Jones' respective wages, and how much should be distributed by way of dividend. Such an approach was raised in argument by my noble and learned friend Baroness Hale of Richmond, but it was not adopted by either party. However, if Mr Gammie was correct in his argument on the first point, then, when Mr Jones, as the sole director of the company, decides each year how to apportion the gross income of the company, I find it very hard to see why that should not be capable of being an arrangement within section 660G (1), if it has been excluded from consideration as part of the arrangement when the shares were acquired by Mr and Mrs Jones. On that basis, I find it also very hard to see why Mr Jones's decision each year not to take anything like a full salary, thereby increasing substantially the dividend payable to his wife, does not involve an element of bounty. Neither Mr Furness QC (no doubt reflecting the Revenue's policy) nor Mr Gammie (as it would involve his clients losing on this issue) was prepared to adopt this approach. Although it appears to me to be logically attractive, it would be inconvenient in practice, in that it would be difficult to administer, and it might well produce unfair, even arbitrary, results. However, the fact that it is not adopted by either party, seems to me rather to support the Revenue on the first issue.

The second issue: was there an "outright gift"?

90. That then brings me to the question of whether, although the transfer of the share in the company to Mrs Jones constituted a "settlement" within section 660A (1), it is nonetheless taken out of the ambit of that section by virtue of being an "outright gift" within section 660A (6). In that connection, three different arguments were raised by the Revenue as to why there was no such "outright gift" in the present case.

91. The Revenue's first argument was that Mrs Jones paid £1 for her share, and that therefore there was no "outright gift", merely a purchase at an undervalue. In my opinion, that point will not do, and it was not strongly pressed by Mr Furness. A purchase at an undervalue involves,

as a matter of ordinary language, an element of gift. There was a "settlement" in the present case because there was an "arrangement", and there was an "arrangement" because, for the reasons already explained, there was a substantial element of "bounty" when Mrs Jones acquired her share. It seems to me very difficult to contend that there was a substantial element of bounty without there having been a gift, albeit that the value of the gift must be diminished by £1 to take into account what Mrs Jones paid for her share. To describe the element of gift in the arrangement as substantial is, in my judgment, a positive understatement in the light of the virtually nominal payment of £1. Once one accepts that there is a gift, it seems to me that the word "outright" is of no assistance in connection with this point.

92. The second argument advanced by the Revenue was that section 660A (6)(b) applied, on the basis that the share concerned was "wholly or substantially a right to income". This argument found favour with the senior commissioner, and, albeit after some hesitation, with Park J (see [2005] EWHC Ch 849, [2005] STC 1667 at para 46). However, I would reject it essentially for the reasons given by Sir Andrew Morritt C, in paragraph 97 of his judgment in the Court of Appeal, [2005] EWCA Civ 1553 [2006] 1 WLR 1123:

> "Each share carries a right to share in dividends duly declared. In addition each share carries the right to share in the distribution of assets in the event of members' winding up and the right to vote at general meetings of the company. The rights attaching to the ordinary shares in the company are unaffected by the alleged arrangement".

It seems to me that an ordinary share, whether in a private or a public company, is for these reasons to be distinguished from a preference share which was held to fall within the ambit of the statutory predecessor of section 660A (6)(b) by Sir John Vinelott in *Young v Pearce*. It may be the case that the main, possibly the sole, reason Mrs Jones acquired a share in the company was to enable her to receive a substantial dividend each year, but section 660A(6)(b) is concerned with the objective character of the property involved, not the subjective reason for which it was acquired. In this connection, I have had the benefit of reading in draft the speech of my noble and learned friend, Lord Hope of Craighead, with which I fully agree.

93. The third, and to my mind the most formidable, ground relied on by the Revenue as to why there was no "outright gift" in the present case was that adopted by Park J as his primary reason (see paragraph 44 and 45), with which the Court of Appeal agreed (see paragraphs 91-93). This argument is that there was "no outright gift" at all. In this connection Mr Furness pointed out that section 660A (6) can only be relied on by a taxpayer where the "settlement" constitutes an "outright gift" and that the reason that the Revenue succeeded on the first main issue is that the "settlement" was more than an outright gift of the share acquired by Mrs Jones (less £1). As Park J put it in paragraph 44 of his judgment:

> "The 'settlement' was an arrangement which included the following elements: the acquisition by Mrs Jones of one share in the [company] for £1; Mr Jones serving the company as an employee; an expectation that he would draw only a modest salary; and an intention that profits would be paid out as dividends. There was far more comprised in that arrangement than would be covered by the expression 'an outright gift'".

94. I see the force of that point, particularly as section 660A (6) is concerned with the question of whether the "settlement", as opposed to the transfer of the property comprised in the settlement, constituted an "outright gift". However, it seems to me that the point wrongly detaches the bounty from the property, and that it contains an element of inconsistency, which is rather similar to the inconsistency in the proposition that, because the share was acquired for £1, it cannot be treated as a gift. The only reason that there is a settlement in the present case is that there is an arrangement involving the acquisition of a share which includes an element of "bounty", as a result of what it is anticipated will happen following the acquisition of the share. In other words, the only reason that there is an "arrangement" is that the share acquired by Mrs Jones was, at the time of acquisition, worth more than she paid for it. I therefore find it difficult to see how one can detach the bounty from the property. The notion that there is a gift of the share arises because of what was anticipated, indeed what was intended, to happen in the future.

95. One could not, I think, say that the gift of a share in a publicly quoted company could not operate as "an outright gift" because the value of the share is not, as it were, inherent, but is based on what it is hoped will happen in the future. The only ground for suggesting that such an approach is justified in the present case is that the existence and

value of the bounty would depend on what one or both of the parties involved in the arrangement, as opposed to third parties, will do in the future. However, I do not see that as a logical or satisfactory reason for concluding that the "settlement" in the present case did not involve "outright gift".

96. I cannot pretend to have found this third point easy, and it is not surprising that Park J and the Court of Appeal reached a different view. However, in common with your Lordships, I have concluded that the Revenue's appeal fails on this ground.

Conclusion

97. In all these circumstances, although my reasons are very different from those of the Court of Appeal, I would dismiss this appeal.